REPORT ON EXAMINATION

OF THE

ULICO CASUALTY COMPANY

AS OF

DECEMBER 31, 2005

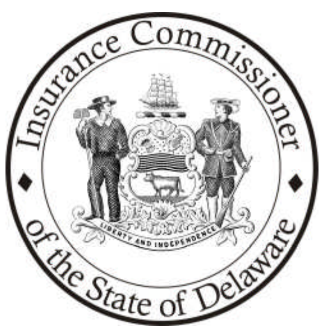
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

ULICO CASUALTY COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Handy

DATE: 29 JUNE 2007



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 29TH DAY OF JUNE 2007.

Matt Denn

Insurance Commissioner

REPORT ON EXAMINATION

OF THE

ULICO CASUALTY COMPANY

AS OF

December 31, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 29TH Day of JUNE 2007.

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December 28, 2006

SALUTATION

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Chairman, NAIC Financial Condition Committee
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Kansas City, Missouri 64108-2604

Honorable Mathew Denn
Delaware Department of Insurance
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Honorable Ann Womer Benjamin
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Honorable D. Kent Michie
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Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06-012, dated April 7, 2006, an Association examination has been made of the affairs, financial condition and management of the

ULICO CASUALTY COMPANY

hereinafter referred to as "Company" or "UCC" and incorporated under the laws of the State of Delaware as a stock company with its home office located at 1209 Orange Street, Wilmington, Delaware. The examination was conducted at the main administrative office of the Company, located at 1625 Eye Street, NW, Washington, DC 20006.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2002. This examination covers the period since that date through December 31, 2005, and consisted of a general review of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

This report is presented on an exception basis. The format of this report is designed to explain the procedures employed on the examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible Company officials during the course of the examination.

The general procedures of the examination followed the rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC") and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc. performed an information systems review.

In addition to items hereinafter incorporated as a part of the written report, the following areas were checked and made part of the work papers of this examination:

Fidelity Bonds and Corporate Insurance
NAIC Ratios
Commitments and Contingent Liabilities
Risk Based Capital
All Assets and Liability Items not mentioned

HISTORY

Ulico Casualty Company was incorporated by The Union Labor Life Insurance Company (Union Labor Life) on May 2, 1979, in the State of Delaware. The Company became part of an insurance company holding system on July 30, 1979, when Union Labor Life purchased 400 shares of common stock of the Company for $4,000,000, of which $2,000,000 represented Capital and $2,000,000 Surplus Paid-In. ULLICO Inc. became the beneficiary of the 500 shares of common stock of the Company previously held by Ulico Holding, which liquidated in 1997.

During 2002, ULLICO Inc., the parent of Ulico Casualty Company, became embroiled in an insider trading investigation. The investigations stemmed from allegations that senior officers had made huge profits by buying ULLICO stock and then reselling the shares to the Company under unusually favorable conditions.

The allegations led to investigations of certain ULLICO officials by the U.S. Attorney General, the Maryland Insurance Commissioner, and the Securities and Exchange Commission. As a result of the investigations, several key officers resigned, retired, or were terminated from employment during 2003. Over the course of this examination period, new management has been put in place and said management is working closely with the Insurance Departments to attempt to comply with all appropriate rules and regulations.

On May 2, 2005, the Company sold its sole subsidiary, Ulico Indemnity Company (UIC). The Company received net proceeds of $25,150,062 resulting in a $2,914,000 increase in surplus.

CAPITALIZATION

As of December 31, 2005, the Company had 500 common shares authorized and outstanding with a par value of $10,000 per share. The Company did not authorize or issue any additional shares since the prior examination. Further, ULLICO Inc. owned all of the outstanding shares.

The schedule below shows the changes in the Company's capital and surplus from the prior examination to the current examination, prior to any changes proposed by this examination. It should be noted that in 2004 a capital contribution totaling $6,306,251 was made to the Company after obtaining approval for the transaction by the Delaware Department of Insurance. UCC requested the permitted practice to offset an overdue tax recoverable from ULLICO Inc. totaling $6,306,251. On February 9, 2005, the Delaware Department of Insurance approved the permitted practice allowing the Company to report the $6,306,251 capital contribution. The approval was based upon SSAP No. 72, paragraph 8, which permits such capital contributions satisfied by a receipt of cash or readily marketable securities occurring prior to filing the annual statement. The examination confirmed receipt of the $6,306,251 capital contribution on January 31, 2005.

	Special Surplus Funds (Notes)	Common Capital Stock	Gross Paid-In & Contributed Surplus	Unassigned Funds (Surplus)	Total
Surplus (12/31/2002)	$0	$5,000,000	$68,289,263	($17,970,667)	$55,318,596
Operations (1)					
2003 Operations	0	0	0	(11,942,794)	(11,942,794)
2004 Operations	0	0	0	1,935,281	1,935,281
2005 Operations	0	0	0	12,950,493	12,950,493
Change in non-admitted assets (2)				(6,306,251)	(6,306,251)
Capital contribution (2)			6,306,251		6,306,251
Surplus (12/31/2002)	**$0**	**$5,000,000**	**$74,595,514**	**($21,333,938)**	**$58,261,576**

(1) Operations is defined as: Net income, net unrealized capital gains and loss, change in net unrealized foreign exchange capital gain and loss, change in net deferred income tax, change in non-admitted assets, change in provision for reinsurance, cumulative effect of changes in accounting principles and aggregate write-ins for gains and losses in surplus.

(2) See the previous paragraph for an explanation of this transaction and why it is disclosed on this chart.

During the examination, it was noted that the Company's 2005 Annual Statement, Financial Note number 13, stated: "The Company has 1000 shares of $10,000 par value common stock authorized. Of the authorized shares, 500 shares are issued and outstanding".

The Note contradicted the Amended Certificate of Authority which stated, "The total number of shares of stock which the corporation is authorized to issue is 500 shares with a par value of $10,000, therefore

It is recommended that the Company properly complete the Annual Statement pursuant to 18 <u>Del. C.</u> §526(a).

MANAGEMENT AND CONTROL

Stockholders

The Company amended its bylaws effective July 21, 2004. Article II, Section 2.3 of the Company's amended bylaws, states in part; "an Annual Meeting of Stockholders shall be held during the month of May for the purpose of electing Directors and the transaction of other business that may be brought before the meeting". Further, any action taken by "Written Consent" shall constitute a valid meeting of Stockholders as if held in person, including, action to be taken at an Annual Meeting of Stockholders.

Board of Directors

The bylaws stipulate that number of Directors shall not be less than five (5), and consist of such a number as determined from time to time by resolution of the Board of Directors. Directors shall be elected at the annual meeting of the Stockholders by majority vote of the Stockholders entitled to vote at the annual meeting. The term of office of all Directors shall be one year.

At December 31, 2005, the members of the Board of Directors together with their principal business affiliation were as follows:

Name Residence and Date Elected /Appointed	**Principal Business Affiliation**
Daniel Aronowitz Falls Church, Virginia Appointed May 19, 2005	President Ulico Insurance Group
David Allen Christhilf South Riding, Virginia Appointed August 20, 2005	Assistant Vice President Ulico Casualty Company
Edward Grebow New York, New York Appointed May 8, 2003 Re-elected May 19, 2005	President ULLICO Inc.
Terence Michael O'Sullivan Vienna, Virginia Appointed May 8, 2003 Re-elected May 19, 2005	General President – Laborers International Union of North America
Mark Ernest Singleton Woodbine, Maryland Appointed December 1, 2003 Re-elected May 19, 2005	Chief Financial Officer ULLICO Inc.

During a review of the 2005 Stockholder meeting minutes it was revealed that the above Directors were properly appointed with the exception of Mr. David A. Christhilf. Although Mr. Christhilf was participating on the Board of Directors the actual appointment did not occur until December, 2005. Therefore,

It is recommended that the Company comply with its bylaws and properly authorize the appointment of all Directors.

It was noted that the Company is reporting appointments of Directors to the Delaware Insurance Department, but not the resignations, removals and other departures, as required by 18 *Del. C.* §4919, which states: "Every domestic stock or mutual insurer shall promptly notify the Commissioner in writing of any change of personnel among it directors or principal officers."

Therefore, as also noted in the prior examination report;

> **It is recommended that the Company promptly report all changes in directors and principal officers to the Delaware Insurance Department, as required by 18 *Del. C.* §4919. These changes must include not only appointments, but resignations, removals and departures.**

Committees

Article IV, Section 4.1 of the bylaws states the Board of Directors, may from time to time appoint permanent or temporary Committees as it deems appropriate to serve its purposes. During the period covered by this examination, there were no Committees of the Board of Directors of the Company.

Officers

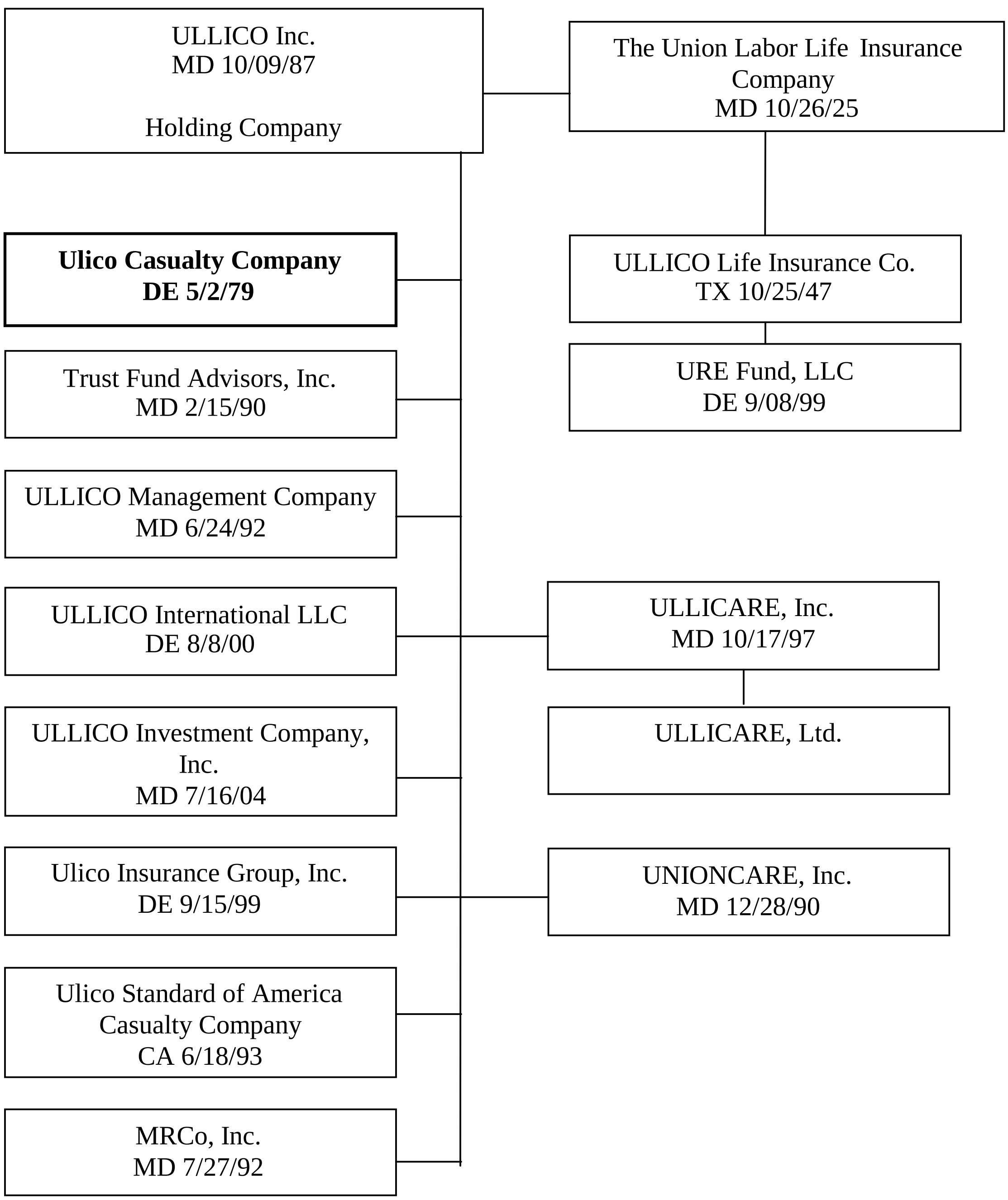
The bylaws state that the officers of the Company shall be chosen by the Board of Directors and shall include a Chairman/Chief Executive Officer, and may include a President, Secretary, Treasurer, and one or more Vice Presidents and Assistants. Also, the same person may hold any number of officer positions, but no person may serve concurrently as both President and Vice President.

At December 31, 2005, the principal officers of the Company were as follows:

Name	**Title**
Terence Michael O'Sullivan	Chairman and Chief Executive Officer
Daniel Aronowitz	President
Teresa Elizabeth Valentine	Secretary
Mark Ernest Singleton	Treasurer, Chief Financial Officer, and Senior Vice President
James McKee Paul	Senior Vice President, Human Resources
Douglas Dvorak	Vice President, Property & Casualty Claims
William Webster Blanton Jr.	Vice President and Chief Actuary
Adam Mark Fried	Assistant Treasurer and Assistant Vice President Tax
David Allen Christhilf	Assistant Vice President, Actuary

HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System. The immediate and ultimate parent of the Company at December 31, 2005 was ULLICO Inc., a Maryland Corporation. The following presentation of the holding company system, as of December 31, 2005:



On May 2, 2005, the Company sold its only subsidiary; Ulico Indemnity Company.

MANAGEMENT AND SERVICE AGREEMENTS

Agreements with Affiliates

Consolidated Income Tax Agreement

Effective December 31, 1987, the Company, along with ULLICO Inc. and affiliates, entered into a Federal Income Tax Sharing Agreement. The Agreement provides that a consolidated federal income tax return shall be filed by the parent for each taxable year the affiliated group is required or permitted to file such a return.

The Agreement specifies the allocation and individual methods to use to compute each member's share of the consolidated tax liability, and stipulates that the inter-company settlement of tax liabilities or tax recoverable is to be made within thirty-days after the filing of the consolidated tax return.

Consolidated Services Agreement

Effective May 1, 1999, the Company entered into a Consolidated Services Agreement with its parent, ULLICO Inc, and affiliates; collectively referred to as the ULLICO Group.
Under the terms of the Agreement, services which may be performed in whole or in part under the Agreement may include, but are not limited to; accounting, tax and auditing, legal, actuarial, financial management, underwriting, claims management, risk management, employee benefit and personnel administration, sales, electronic data processing operations, communications operations and investment services.

Participating affiliates that perform any of these services for another member of the Group may charge a fee based upon the cost of the services rendered. Also, the Agreement provides for a fee for corporate oversight to be paid quarterly to it ultimate parent; ULLICO, Incorporated.

Marketing and Underwriting Agreement

Effective September 1, 2004, the Company entered into an Inter-Company Marketing and Underwriting Agreement with its subsidiary, ULICO Indemnity, and affiliate Ulico Insurance Group ("UIG"). Under terms of the Agreement, the Company appointed UIG to perform its exclusive marketing and underwriting functions in all states in which the Company is licensed.

The Company failed to file the affiliated agreement with the Delaware Department of Insurance pursuant to 18 *Del. C.* § 5005. Therefore;

It is recommended that the Company notify the Delaware Department of Insurance thirty days prior to entry into, or the amendment to, any affiliated management, service or cost sharing agreements in accordance with 18 *Del. C.* § 5005.

During the period of examination, holding company filings were issued to the Delaware Department of Insurance and approval was provided contingent upon the Company providing a copy of the executed documents; along with an affidavit attesting the executed agreement had not been altered from the original filing. The Company failed to comply with this Department directive. Therefore;

It is recommended that the Company comply with the directive issued by the Delaware Department of Insurance regarding Holding Company transactions, and provide a copy of the executed documents; along with an affidavit attesting the executed agreement was not altered from the original filing.

Agreements with Non-Affiliates

Custodial Agreement

On March 7, 1995, the Company entered into a custodial agreement with Mellon Bank for the purpose of safekeeping the Company's invested assets. The Agreement, as amended on July 2, 2003, did not include adequate indemnification language as specified by the NAIC. Therefore;

> **It is recommended that the Company amend the Custodial Agreement to add indemnification language, which obligates the custodian to indemnify the insurance company for any loss of securities while under the care of the custodian.**

Risk Management Planning Group

Effective June 1, 1996, and automatically renewed on an annual basis beginning June 1, 1999, the Company entered into a third party administrator agreement with Risk Management Planning Group ("RMPG"). The Agreement defines claims administrative services (for workers' compensation claims incurred in the Northeast region of the Country) to be provided by RMPG during the term of the agreement, relative to the day-to-day affairs of the Company, subject to the superior authority of the Company.

Strategic Alliance Agreement - Farmers Group, Inc.

Effective May 8, 2001, the Company, UIC and UIG entered into a strategic alliance agreement with Farmers Group, Inc. on behalf of its affiliated exchanges and subsidiaries for the purpose of jointly marketing property and casualty insurance products and services to union members through local and national union leaders, and the reinsurance of a portion of the program thereof by the Company.

Under terms of the Agreement, the Farmers Insuring Entities shall be given the exclusive right to offer and sell personal lines property and casualty insurance to union members through local and national union leaders. Conversely, the Company will be the only entity in the United States with which Farmers enters into an alliance for the purpose of establishing an affinity group for union members to be marketed and endorsed by local and national union leaders. Subject to terms of the agreement, the agreement shall run until December 31, 2006 unless terminated earlier.

GROWTH OF THE COMPANY

The following information was extracted from the Company's filed Annual Statements:

Year	Net Admitted Assets	Surplus as Regards to Policyholders	Gross Premiums Written	Net Premiums Written	Net Income
2005	$136,133,767	$58,261,576	$33,228,562	$25,063,312	$9,841,698
2004	133,290,179	45,311,083	31,771,025	25,954,903	(3,755,323)
2003	145,536,615	43,375,802	68,488,468	33,418,740	(13,626,721)
2002	132,928,474	55,318,596	83,352,790	41,255,151	(10,756,929)
2001	167,624,914	67,970,519	78,117,368	33,115,248	2,345,451

Although the Company grew aggressively during the late 1990's, as a result of poor profitability and considerable adverse development in the workers' compensation, surety, and later, in the accident and health markets, the Company began a concentrated review of its business strategy. The result of this review prompted the Company to implement a restructuring program in July of 1999, which included exiting poorly performing markets and lines of business (traditional workers' compensation, surety, commercial contractors liability and accident & health); allowing management to focus solely on selling its core products (fiduciary liability, union liability, commercial lines, and collectively bargained (ADR) workers' compensation) to Labor Unions and related organizations.

In 2003, the decrease in direct premium writings reflects the transference of discontinued lines of business to an affiliate, Ulico Standard of America Casualty Company; and the resulting reallocation of assets to profitable core lines of business. Also in 2003, the Company initiated reserve strengthening for several of its lines of business. This was due, in part, to adverse development from prior years and from recognizing that industry experience in the workers' compensation line of business continued to be worse due to a number of external factors.

On March 7, 2003, A. M. Best downgraded UCC to B (Fair) and cited: "The rating applies to Ulico Insurance Group's (UIG) two inter-company pool members, led by Ulico Casualty Company. This rating reflects the Group's volatile and overall unfavorable operating results, as evidenced by the negative five-year average returns on revenue and policyholders' surplus, and elevated risk surrounding numerous levels within the entire organization, including the limited financial flexibility of the parent holding company, ULLICO Inc. UIG provides fiduciary liability, union liability, collectively bargained and Union Hall workers' compensation programs and other commercial products for labor unions, organized employees and Taft-Hartley Trust Funds, in combination representing an affinity group with approximately 16.5 million active members and dependents, 9.0 million public employee members plus dependents and 7.0 million retired members and dependents. Although UIG continues to focus operations on its core fiduciary and union liability lines of business, operating earnings continue to be weighed down, historically by the discontinued workers' compensation and group accident and health lines of business which have generated sizeable one-time expenses. Most recently, sizeable losses have been generated in its core lines of business, fiduciary liability, a high severity line, and commercial lines, with adverse development resulting from an increase in claims frequency."

In 2004, the Company entered into a loss portfolio transfer to its then subsidiary ULICO Indemnity Company (Indemnity) 100% of loss and loss adjustment expense (LAE) reserves and unearned premiums outstanding of Indemnity at July 1, 2004 on union liability and the trustee and fiduciary liability lines of business. The Company assumed loss, LAE and unearned premiums of $4,500,000 from Indemnity effective July 1, 2004 and received from Indemnity $4,500,000 of premium to assume these reserves.

During 2004, the Company's parent company, ULICO, Inc. provided a capital contribution of $6,306,000 that is included in the "Surplus as Regards Policyholders" in the above chart.

On May 2, 2005, the Company sold its subsidiary insurer, Ulico Indemnity Company. The Company received net proceeds of $25,150,000. The statement value of Ulico Indemnity Company at the time of the sale was $22,236,000, resulting in a $2,914,000 increase in surplus.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2005, the Company was licensed to write business in all states and the District of Columbia with the exception of Maine, New Hampshire and Rhode Island. The Company operates on a surplus lines or non-admitted basis in Puerto Rico and Rhode Island. The Company is licensed to write fiduciary liability, union liability, collectively bargained and Union Hall workers' compensation, and other commercial products (commercial liability and commercial property). The Company's customers are institutional (benefit trust funds, including Taft-Hartley Trust Funds), commercial (union organizations, union officers and organized employers) and individual (union members and their dependents).

Plan of Operation

At December 31, 2005, approximately sixty-six percent (66%) of the direct premium written was produced in five states.

Major 2005 direct premium writings by state ($000) were: California, $4,246 (32.9%); District of Columbia, $1,584 (12.3%); Florida, $1,034 (8.0%); Pennsylvania $893 (6.9%); New York, $699 (5.4%); all other jurisdictions, $4,448 (34.0%).

REINSURANCE

For 2005, the Company reported the following distribution of net premiums written:

Direct business	$12,904,299
Reinsurance assumed (from affiliates)	0
Reinsurance assumed (from non-affiliates)	20,324,263
Total direct and assumed	$33,228,562
Reinsurance ceded (to affiliates)	$483,582
Reinsurance ceded to (non-affiliates)	7,681,668
Net premiums written	$25,063,312

The Company had the following reinsurance programs and agreements in effect as of December 31, 2005:

Assumed:

The Company had five assumed reinsurance contracts in place with unaffiliated companies as of December 31, 2005, with the two largest being State National Insurance Company, Inc. (87%) and Zurich American Insurance Company (12%). The balance of the total was derived from Farmers Insurance Exchange, Fire Insurance Exchange and Legion Insurance Company.

State National Insurance Company

On February 1, 2004, Ulico Insurance Group (UIG), a wholly-owned general agency of ULLICO Inc., and the Company entered into an agreement with State National Insurance

Company (State National) to offer fiduciary liability coverage to labor unions and jointly managed trust funds. UIG underwrites, quotes, issues and services the policies. Under a quota share agreement, the Company assumes 100% of the written premium and loss and loss adjustment expenses. The Company administers premium billing and claims processing on behalf of UIG and State National.

On July 1, 2005, UIG and the Company amended the agreement with State National to add union liability coverage to labor unions. UIG underwrites, quotes, issues and services the policies. Under a quota share agreement, the Company assumes 100% of the written premium, loss and loss adjustment expenses.

Zurich North American Insurance

Effective July 1, 2003, Ulico Insurance Group (UIG), a wholly-owned general agency of ULLICO Inc., was appointed by Zurich North America Insurance (Zurich) as the exclusive Program Administrator for Alternative Dispute Resolution (ADR) workers compensation programs authorizing the quotation and issuance of “A” rated Zurich policies. UIG provided services and ADR expertise under a commission based fee structure. The Company provided premium billing, collection services, and claims management on behalf of UIG. Effective October 1, 2004, this agreement was renegotiated so that UIG provided a much narrower service for a reduced commission. The Company continued its premium billing and collection services, but no longer provided claim processing. Along with the renegotiated service agreement, the Company entered into a quota share agreement with Zurich to assume 10% of this business. This quota share agreement terminated September 30, 2005.

During the examination it was revealed that the Company had established trust funds for four reinsurance agreements in which the funds held in trust exceeded the amount of the liabilities in violation of SSAP No. 4. As of December 31, 2005, the amount in excess of ceded liabilities, totaled $29,620,000, and was considered a non-admitted asset pursuant to SSAP No. 62 (20). Therefore,

> **It is recommended that the Company review pledged assets and non-admit all amounts which exceed ceded liabilities as required by the NAIC Accounting Practices and Procedures Manual, SSAP No. 62 (20)**.

In addition, it was noted that the Company failed to report the pledged assets on Schedule E, Part 3 as required by the NAIC Annual Statement Instructions. Therefore,

> **It is recommended that the Company follow the NAIC Annual Statement Instructions in the preparation of its annual statement and list all pledged assets.**

<u>Loss Portfolio Transfer</u>**:**

Effective July 1, 2004, the Company entered into a loss portfolio transfer (LPT) agreement with its then subsidiary, Ulico Indemnity Company. The Agreement ceded 100% of the loss and LAE reserves and UPR as of July 1, 2004 to the Company. This Agreement was terminated and Prior Notice of Termination of Several Agreements was issued to the Department through a Form D filing dated April 18, 2005. The filing also sought approval of a new 100% quota share reinsurance agreement in which Ulico Indemnity Company ceded 100% of all reinsured liabilities to the Company. The LPT and the quota share agreement were approved by the Delaware Department of Insurance on April 20, 2005.

<u>Ceded</u>**:**

The Company's ceded reinsurance program consisted of primarily two components. The first component was for Workers Compensation insurance in which the Company obtained excess of loss policies providing varying levels of coverage during the examination period.

Effective November 1, 2003, the Company had three layers of excess coverage. The first layer provided coverage of $9,250,000 in excess of $750,000; the second layer provided coverage of $20,000,000 in excess of $10,000,000 and the third layer provided coverage of $10,000,000 in excess of $30,000,000 for total coverage of $40,000,000 in excess of $750,000. These three contracts were in effect until November 1, 2004.

Effective November 1, 2004 through December 31, 2005, the Company had coverage of $8,000,000 in excess of their retention of $2,000,000. It was noted that the Company reduced its coverage by 75% as of November 1, 2004. A reinsurance intermediary, Guy Carpenter, administers the reinsurance program and places the cessions with a pre-approved list of reinsurers.

The second component was coverage for the Fiduciary lines of business referred to as Union/Taft Hartley Trustee, Corporate Trustee and Fiduciary Liability. The Company obtained the following excess coverage for these lines of business. The first layer became effective as of April 1, 2005. Under the terms of the agreement the Reinsurer provided $3,000,000 each, and every, loss excess of $2,000,000 (referred to as Layer A-Primary Business). An additional reinsurance agreement was entered into which covered a 30% share of all business, up to a limit of $10,000,000 each policy, excess of the underlying policy (referred to Layer B-excess business).

For the second layer of reinsurance, effective April 1, 2005, the Reinsurers provided $5,000,000 of coverage excess of $5,000,000 on any one claim and in the aggregate. In addition, a quota share agreement effective April 1, 2005 was entered into whereby the reinsurer covers 50% of $10,000,000 each policy, excess of underlying policy (referred to as Layer B-excess business). Guy Carpenter, the reinsurance intermediary, also administers this reinsurance program and places the cessions with a pre-approved list of reinsurers.

Effective February 26, 2001, the Company and its subsidiary, Ulico Indemnity Company, entered into a reinsurance agreement with an unauthorized affiliate, Ulico Standard of America Casualty Company (USA Casualty). The purpose of the Agreement was to cede 100% of workers' compensation business produced before July 2000 to USA Casualty.

During the examination of Schedule F - Part 5 it was noted that the Company had reported $31,967,000 in Column 10, titled - Other Allowed Offset Items. The amount represented the offset of a reinsurance recoverable amount due from an unauthorized affiliate, USA Casualty.

The Company and USA Casualty entered into an Escrow Agreement on April 30, 2003, with Mellon Bank acting as Escrow Agent. During the examination of the December 31, 2005 escrow account statement it was noted that the account contained $15,326,729, which was not adequate to cover the liabilities ceded to USA Casualty totaling $31,967,000. Since USA Casualty is unauthorized in the State of Delaware, the deficiency in the escrow account is a violation of the NAIC Accounting Practices and Procedures Manual, SSAP No. 62 which states, in part: "Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution...." "The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities..." The escrow account established by the unauthorized affiliate was not adequate to meet the requirements of the NAIC Accounting Practices and Procedures Manual, SSAP No. 62, and therefore,

It is recommended that the Company follow the guidance established under SSAP No. 62 and obtain adequate security from unauthorized reinsurers; such collateral shall include letters of credit, funds held or trust funds.

ACCOUNTS AND RECORDS

During a review of the Company's information system security policies and procedures, it was observed that the Company failed to develop a formal emergency response procedure. In addition, it was noted that the Company lacked adequate documentation of departmental procedures or local business continuity plans at the business unit level. These policies and procedures are necessary to allow the Company to properly respond to emergencies and continue operations in the event of a disaster, therefore,

It is recommended that the Company develop a comprehensive emergency and business continuity plan.

The Company's 2005 Annual Statement states in its Notes to Financial Statements – Note 13: "The Company has 1000 shares of $10,000 par value common stock authorized. Of the authorized shares, 500 shares are issued and outstanding." The Note language does not agree with the Company's Amended Certificate of Authority as issued by the Delaware Secretary of State. That document states: "The total number of shares of stock which the corporation is authorized to issue is 500 shares with a par value of $10,000.", therefore,

It is recommended that the Company file its future Annual Statements in accordance with 18 *Del. C.* §526(a), and in compliance with the Company's Amended Certificate of Authority.

Independent Accountants

The firm of PriceWaterhouse Coopers, LLP audited the Company's financial statements until 2003, the first year covered by this examination report. In 2004, Ernst & Young, LLP

(E&Y) was appointed as the Company's external audit firm. The firms issued unqualified opinions for each year of the examination period pertaining to their respective audits.

Actuarial Opinion

The Company's loss reserves and related actuarial items were reviewed by Brian Z. Brown, FCAS, MAAA of Milliman Inc., who was appointed by the Company to render a statement of actuarial opinion, based on the financial information presented by the Company with the assistance of David Christhilf, ACAS, MAAA, Chief Actuary for the Company. The opinion stated that the reserves and related actuarial values carried on the balance sheet were fairly stated and met the requirements of the insurance laws of the state of Delaware.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2005, as determined by this examination, along with supporting exhibits as detailed below:

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Capital and Surplus Account
Schedule of Examination Adjustments

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding. Write-ups on the individual accounts in the Notes to Financial Statements section of this Report are presented on an exception basis. Only comments relative to adverse findings, material financial changes or other significant regulatory concerns are noted.

Assets
December 31, 2005

	Ledger Assets	Assets not Admitted	Net Admitted Assets	Notes
Bonds	$117,198,976	$29,620,000	$87,578,976	1
Cash and short-term investments	11,028,975		11,028,975	
Investment income due and accrued	991,419		991,419	
Uncollected premiums and agents' balances in the			0	
course of collection	1,924,022	430,318	1,493,704	
Amounts recoverable from reinsurers	2,674,214		2,674,214	
Funds held by or deposited with reinsured companies	134,646		134,646	
Net deferred tax asset	4,467,143	4,467,143	0	
Guaranty funds receivable or on deposit	99,362		99,362	
Electronic data processing equipment and software	1,147	1,147	0	
Receivables from parent, subsidiaries and affiliates	764,173		764,173	
Aggregate write-ins for other than invested assets:			0	
Taxes receivable	349,000		349,000	
Accounts receivable	213,000		213,000	
User funding assessment receivable	364,881		364,881	
Deposit for claims processing	811,417		811,417	
Deposit for third party administrator (TPA)	10,000		10,000	
Assets non-admitted	6,634	6,634	0	
Total Assets	$141,039,009	$34,525,242	$106,513,767	

Statement of Liabilities, Surplus and Other Funds
December 31, 2005

		Notes
Losses	$41,016,809	2
Reinsurance payable on paid losses and loss adjustment expenses	31,212	
Loss adjustment expenses	22,007,965	2
Other expenses	238,769	
Taxes, licenses and fees	633,059	
Net deferred tax liability	821,709	
Unearned premiums	9,335,634	
Ceded reinsurance premiums payable	1,672,981	
Funds held by company under reinsurance treaties	134,646	
Provision for reinsurance	16,700,524	3
Payable to parent, subsidiaries and affiliates	988,393	
Aggregate write-ins for liabilities:		
Escheated funds	260,409	
Clearing/Suspense accounts	91,458	
Contingent commission payable	578,813	
Total Liabilities	$94,512,381	
Common capital stock	5,000,000	
Gross paid in and contributed surplus	74,595,513	
Unassigned funds (surplus)	(67,594,127)	
Surplus as regards policyholders	12,001,386	
Total Liabilities, Surplus and Other Funds	$106,513,767	

Statement of Income
As of December 31, 2005

Underwriting Income

Premiums earned	$23,623,471
Deductions:	
Losses incurred	9,684,101
Loss expenses incurred	2,519,784
Other underwriting expenses incurred	11,507,592
Total underwriting deductions	$23,711,477
Net underwriting gain or (loss)	(88,006)

Investment Income

Net investment income earned	3,920,420
Net realized capital gains or (losses)	6,858,678
Net investment gain or (loss)	$10,779,098

Other Income

Net gain or (loss) from agents' or premium balances charged off	(49,360)
Aggregate write-ins for miscellaneous income:	
Miscellaneous income	226,269
Total other income	$176,909
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	10,868,001
Dividends to policyholders	84,594
Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	10,783,407
Federal and foreign income taxes incurred	941,709
Net income	$9,841,698

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004	$45,311,083
Net income	9,841,698
Change in net unrealized capital gains or (losses)	(3,415,296)
Change in net deferred income tax	(2,085,128)
Change in nonadmitted assets	(21,097,724)
Change in provision for reinsurance	(16,553,247)
Change in surplus as regards policyholders for the year	($33,309,697)
Surplus as regards policyholders, December 31, 2005	$12,001,386

Schedule of Examination Adjustments

Annual Statement Item	Per Company	Per Examination	Increase/ (Decrease) to Surplus
Bonds	$117,198,976	$87,578,976	($29,620,000)
Provision for Reinsurance	60,333	16,700,524	(16,640,191)
Total Examination Adjustments			($46,260,191)
Company Surplus as Regards Policyholders			58,261,577
Examination Surplus as Regards Policyholders, as of December 31, 2005			$12,001,386

NOTES TO FINANCIAL STATEMENTS

Note 1 Bonds: **$87,578,976**

During the examination it was revealed that the Company had established trust funds for four reinsurance agreements in which the funds held in trust exceeded the amount of the assumed liabilities in violation of SSAP No. 62 (20). The amount in excess of ceded liabilities, totaling $29,620,000, was considered a non-admitted asset as defined in SSAP No. 4. As a result, the amount reported for Bonds was reduced from $117,198,976 to $87,578,976.

The Company failed to comply with SSAP No. 62 (20). Pursuant to SSAP 4, which states in part, "Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet, and are, therefore, considered non-admitted," therefore,

It is recommended that the Company review pledged assets and non-admit all amounts that exceed ceded liabilities as required by the NAIC Accounting Practices and Procedures Manual, SSAP No. 62 (20).

Note 2 Losses: **$41,016,809**

Loss Adjustment Expenses: **$22,007,965**

The Delaware Insurance Department retained the services of a consulting actuary, Michael W. Morro, ACAS, MAAA with the actuarial firm of INS Consultants, Inc. for the purposes of conducting an independent review of the Company's loss and loss adjustment expense reserves as of December 31, 2005. The Consulting Actuary was provided with the Company's statement of actuarial opinion that was prepared and signed by Brian Z. Brown, FCAS, MAAA with the actuarial firm of Milliman, Inc., who was appointed by the Board of

Directors of the Company to render an opinion of the loss and loss adjustment expenses (LAE) reserves of the Company. Mr. Brown relied upon the data and related information prepared by the Company by David Christhilf, ACAS, MAAA, Chief Actuary for the Company as of December 31, 2005

The Department's Consulting Actuary's review of loss and LAE reserves consisted of separately analyzing the Ulico Property and Casualty Companies (the Company and USA Casualty combined) book of business on a gross and net basis. In addition, for unallocated loss adjustment expense, the Department's Consulting Actuary reviewed the methodology employed by Milliman, Inc.

Upon completion of the Department's Consulting Actuary's review, the Company's net loss and LAE reserves were estimated at $63,002,000. This compares to the Company's reported statutory net reserve of $63,024,774. This represents a redundancy of $22,774, an insignificant difference from the amount established by the Company. The gross reserves, as determined on a consolidated/pre-allocation (combined Company and USA Casualty) basis, are estimated at $89,428,000, which compares to the held reserve of $93,536,000. The gross reserve redundancy is $4,108,000, or 4.4% of the held statutory gross reserve. In summary, it appears that the Company's stated year-end 2005 reserves (both gross and net) are adequate as determined by the Department's Consulting Actuary.

Note 3 Provision for Reinsurance: **$16,700,524**

During the examination of Schedule F - Part 5 it was noted that the Company had reported $31,967,000 in Column 10, titled - Other Allowed Offset Items. The amount represented an offset of a reinsurance recoverable amount due from an unauthorized affiliate, USA Casualty.

The Company and USA Casualty entered into an Escrow Agreement on April 30, 2003, with Mellon Bank acting as Escrow Agent. During the examination of the December 31, 2005 escrow account statement it was noted that the account contained $15,326,729, which was not adequate to cover the liabilities ceded to USA Casualty totaling $31,967,000. As a result, the examination increased the Provision for Reinsurance from $60,333 to $16,700,524. Since USA Casualty is unauthorized in the State of Delaware, the deficiency in the escrow account is a violation of the NAIC Accounting Practices and Procedures Manual, SSAP No. 62, therefore,

> **It is recommended that the Company follow the guidance established under SSAP No. 62 and obtain adequate security from unauthorized reinsurers; such collateral shall include letters of credit, funds held or trust funds.**

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

A review was performed of appropriate balance sheet and forepart files to verify corrective action had been taken with regards to prior examination report comments and recommendations.

Management and Control

1. It was recommended that the Company report all changes in directors and principal officers to the Delaware Insurance Department as required by Del. 18, C. § 4919.

   During the current examination, a review of all changes to officers and directors of the corporation during the examination period resulted in a finding that not all changes had been reported to the Delaware Insurance Department in accordance with 18, *Del C.* §4919. Accordingly, the prior report recommendation remains open as of December 31, 2005.

2. It was recommended that the Company verifies that all officers, directors and key employees on an annual basis fill out conflict of interest questionnaires in accordance with ULLICO Inc.'s adopted corporate resolution, NAIC Annual Statement Instructions and 18 *Del. C.* § 526 (a). Furthermore, it is recommended that the Company maintain copies of all completed conflict of interest questionnaires on-site and available for future examination in accordance with ULLICO Inc.'s adopted corporate resolution, NAIC Annual Statement Instructions and 18 *Del. C.* § 526 (a).

   During this examination a review of the Conflict of Interest Questionnaires revealed the Company has complied with the prior exam report recommendation.

3. It was recommended that Corporate Legal ensure that the Company's Articles of Incorporation be amended in accordance with 8 *Del. C.* § 242 to properly reflect the correct par value per share of common capital stock as $10,000, and that the amendment be filed with the Secretary of State of the State of Delaware in accordance with 8 *Del. C.* § 103. Further, it is recommended that a copy of the filed amendment to the Articles of Incorporation be provided to the Delaware Insurance Department.

   During this examination, it was noted that the Company had amended its Articles of Incorporation in accordance with 8 *Del. C.* § 242, and the document now properly reflects the correct par value per share of common capital stock as $10,000. The amendment was filed with both the Secretary of State of the State of Delaware in accordance with 8 *Del. C.* § 103 and the Delaware Department of Insurance.

4. It was recommended that the Management of the Company operate the Company in accordance with its Corporate bylaws, or amend its Corporate bylaws to clarify the usage of

"Consents in Lieu of Meeting" by the sole Stockholder, and "Actions without a Meeting" by the Board of Directors, as was indicated would be performed in response to prior exam report comments.

The Company amended its bylaws on July 21, 2004 to permit “Consents in Lieu of a Meeting” and “Actions without a Meeting”. The Company appears to be operating in compliance with its current bylaws.

5. It was recommended that the Board of Directors adhere to the corporate bylaws as amended and restated, by electing the required number of directors and principal officers.

   Based upon a review of the Board of Director meeting minutes the Company appears to be operating in compliance with its current bylaws.

6. It was recommended that the Board approves and the minutes reflect the operations of the Company, which include, but are not limited to the approval of all investments as required by 18 *Del. C.* § 1304 and Article VI of the Corporate bylaws.

   The corporate records indicate the Board of Directors properly approve investment transactions pursuant to 18 *Del. C.* § 1304.

7. It was recommended that the Company notify the Delaware Department of Insurance thirty (30) days prior to entry into any affiliated management, service or cost sharing agreements in accordance with 18 *Del. C.* §5005 (a) (2), and 18 *Del. C.* § 5005 (a) (2) (d).

   During this examination it was noted that the Company failed to file the Inter-Company Marketing and Underwriting Agreement with the Delaware Department of Insurance pursuant to 18 *Del. C.* § 5005 (a) (2) (d). Accordingly, the prior report recommendation remains open as of December 31, 2005.

8. It was recommended that in the future, the Company comply with all provisions of MGA, MGU and TPA agreements, especially with regards to the formal termination provisions of these types of agreements.

   Based on a review of all external agreements for the period under examination, the Company has complied with the prior exam report recommendation.

9. It was recommended that the Company provide notification within 30 days of the Company's entry into or termination of a contract with an MGA in accordance with 18 *Del. C.* § 1805 (e). Additionally, it is recommended that the Company comply with all requirements set forth under Chapter 18 of Title 18.

   Based on a review of all external agreements for the period under examination the Company is in compliance with 18 *Del. C.* § 1805 (e), and is in compliance with the prior examination recommendation.

10. It was recommended that the Company comply with 18 *Del. C*. § 320 (c), and maintain all records necessary for the performance of Delaware's tri-annual examinations.

    During the course of this examination the Company has promptly provided all records requested, and operated in compliance with the prior examination recommendation.

11. It was recommended that the Company complete its annual statement blank in accordance with NAIC Annual Statement Instructions and 18 *Del. C.* § 526 (a), verifying that all financial and non-financial data is reported accurately, completely, and appropriately.

    The Company's 2005 Annual Statement states in its Notes to Financial Statements – Note 13: "The Company has 1000 shares of $10,000 par value common stock authorized. Of the authorized shares, 500 shares are issued and outstanding." The Note language does not agree with the Company's Amended Certificate of Authority as issued by the Delaware Secretary of State. That document states: "The total number of shares of stock which the corporation is authorized to issue is 500 shares with a par value of $10,000." Therefore, the Company continues to be in violation of 18 *Del. C.* § 526 (a).

12. It was recommended that the Company review agents' balances and non-admit all premiums in the course of collection more than 90 days past due as required by 18 *Del. C.* § 1101 (5) and SSAP 6, Paragraph 9 (a).

    During this examination a review of agents' balances was performed, and based upon the review it appears that the Company is operating in compliance with 18 *Del. C.* § 1101 (5) and SSAP 6, Paragraph 9 (a), and was deemed to be in compliance with the prior examination recommendation.

13. It was recommended that the Company develop a reporting process that allows for the proper aging of premiums in the course of collection.

    Based upon a review of premiums in the course of collection, the Company has developed a reporting process that allows for the proper aging of premiums in the course of collection and is compliance with the prior exam recommendation.

14. It was recommended that the Company develop monitoring controls to ensure that billing and collection efforts are consistent with the underwritten policy, the payment plan entered on Point, and any subsequent underwriting changes.

Based upon a review of billing and collection procedures, the Company appears to have adequate monitoring controls in place to ensure that billing and collection efforts are consistent with the underwriting policies of the Company.

15. It was recommended that the Company non-admit all impaired assets, which meet the conditions of SSAP 5, and similarly represent non-admitted assets in accordance with 18 *Del. C.* § 1101 (11) and (14).

    Based upon a review of the Company's assets, the Company appears to be in compliance with SSAP No. 5 as recommended by the prior examination report.

16. It was recommended that the Company report as admitted assets, only the costs associated for EDP Equipment/Systems which have an initial investment complying with the provisions of 18 *Del. C.* § 1101 (13).

    Based upon a review of the reporting of EDP Equipment/Systems, the Company appears to be in compliance with the prior examination recommendation.

17. It was recommended that the Company provide sufficient provision for adverse development in calculating its reserve liabilities.

    Based upon a review of the loss and the LAE reserves by the Department's consulting actuary, it was found that the Company did provide sufficient provision for adverse development in calculating its reserve liabilities for the period under examination.

18. It was recommended that the Company take the following specific actions with regard to the Ceded Reinsurance Premiums Payable liability account: (1) Comply with all terms of reinsurance contracts, especially terms of settlement of account balances; (2) Implement

internal controls to establish accountability for the booking of reinsurance transactions; (3) Establish procedures requiring management to review and sign-off on monthly and/or quarterly settlements of reinsurance contracts; (4) Perform a 100% review of all active reinsurance contract open balances, including the aging and offsetting of balances, to ensure amounts are valid, supported, and properly booked.

Based upon a review of the Company's Ceded Reinsurance Premiums Payable liability account, the Company appears to be in compliance with the prior examination recommendations.

19. It was recommended that the Company comply with 18 *Del. C.* § 2304 (17) and maintain a complete record of all complaints received. This record shall indicate at a minimum, the total number of complaints, classification by line of business, the nature of each complaint, the disposition of these complaints, and the time it took to process the complaint.

    This examination did not perform market conduct examination procedures. The Delaware Department of Insurance will conduct a separate market conduct examination of this Company.

SUMMARY OF RECOMMENDATIONS

1. It is recommended that the Company properly complete the Annual Statement pursuant to 18 *Del. C.* §526(a). (Page 5)
2. It is recommended that the Company comply with its bylaws and properly authorize the appointment of all Board of Directors. (Page 7)
3. It is recommended that the Company promptly report all changes in directors and principal officers to the Delaware Insurance Department, as required by 18 *Del. C.* § 4919. These

changes must include not only appointments, but resignations, removals and departures. (Page 8)

4. It is recommended that the Company notify the Delaware Department of Insurance thirty days prior to entry into or the amendment to any affiliated management, service or cost sharing agreements in accordance with 18 *Del. C.* § 5005. (Page 11)
5. It is recommended that the Company comply with the directive issued by the Delaware Department of Insurance regarding Holding Company transactions, and provide a copy of the executed documents; along with an affidavit attesting the executed agreement had not been altered from the original filing. (Page 11)
6. It is recommended that the Company amend the Custodial Agreement to add indemnification language that obligates the custodian to indemnify the insurance company for any loss of securities while under the care of the custodian. (Page 12)
7. It is recommended that the Company review pledged assets and non-admit all amounts that exceed ceded liabilities as required by the NAIC Accounting Practices and Procedures Manual, SSAP No. 62 (20). (Pages 18 & 27)
8. It is recommended that the Company follow the NAIC Annual Statement Instructions in the preparation of its annual statement and list all pledged assets. (Page 18)
9. It is recommended that the Company follow the guidance established under SSAP No. 62 and obtain adequate security from unauthorized reinsurers; such collateral shall include letters of credit, funds held or trust funds. (Pages 21 & 29)
10. It is recommended that the Company develop a comprehensive emergency and business continuity plan. (Page 21)

11. It is recommended that the Company file its future Annual Statements in accordance with 18 *Del. C.* §526(a), and in compliance with the Company's Amended Certificate of Authority. (Page 21)

SUMMARY COMMENTS

- On March 7, 2003, A. M. Best lowered the Company's rating from B++ to B. Reasons cited for the reduction were the limited financial flexibility of the parent holding company, ULLICO Inc. and ongoing operating losses.
- During 2003, the Company experienced a complete change in senior management including new Board of Directors and Senior Officers.
- Management restructured operations and discontinued writing poorly performing lines of business.
- The Company reported net income of $9,841,698 in 2005 after three years of net losses.
- As a result of this financial examination, two exceptions were noted which reduced surplus by $46,260,191 from a reported $58,261,577 to $12,001,386.
- On December 7, 2006, A.M. Best announced a rating upgrade for Ulico Casualty Company from B to B+.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior

Per Examination	Examination as of December 31, 2002	Examination as of December 31, 2005	Per Examination
Assets	$130,452,228	$106,513,767	($23,938,461)
Liabilities	$88,301,939	$94,512,381	$6,210,442
Capital and Surplus	$42,150,291	$12,001,386	($30,148,905)

examination with changes between the examination periods:

In addition to the undersigned, James Blair, CFE, CPA, John Coleman, CFE, Larry Cross, CFE, and Raymond Hartsfield, CFE., actuarial assistance was provided by INS Consultants, Inc.

Respectfully submitted,

Patrick R. White, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC

Hilary C. Solomon

Hilary C. Solomon, CFE
Senior Examiner
State of California
Western Zone, NAIC

SUBSEQUENT EVENTS

Bonds

As of December 31, 2005 Company had bonds in trust funds as collateral supporting four assumed reinsurance agreements in which the funds held in trust exceeded the amount of the liabilities. As of December 31, 2005, the amount held in trust in excess of ceded liabilities totaled $29,620,000 and was determined to be a non-admitted asset pursuant to SSAP No. 62(20).

Subsequent to the examination, the Company reduced the amount of funds held in trust in excess of liabilities by renegotiating or entering into new reinsurance arrangements. Effective January 1, 2007, the Company amended its agreement with State National Insurance Company to reduce the collateral requirements. In addition, there was an ongoing run-off of liabilities in the other three reinsurance agreements. As of December 31, 2006, the amount of funds held in trust in excess of ceded liabilities totaled $14,778,000. As of March 31, 2007, the amount of funds held in trust in excess of ceded liabilities totaled $12,433,000. These changes resulted in an increase to the admitted value of Bonds and an increase to Surplus of $14,842,000 and $17,187,000 respectively.

In June 2007, the Company entered into a letter of intent for a new quota share agreement for the fiduciary and union liability lines of business. If the new agreement is consummated, the Company will not be required to pledge any funds in excess of ceded liabilities. This new agreement will result in further significant reductions in non-admitted assets and resulting increases in surplus.

Provision for Reinsurance

The Company ceded 100% of its workers' compensation business produced before July 2000 to its affiliate, USA Casualty. As of December 31, 2005 the escrow account established by USA Casualty, an unauthorized reinsurer, to secure the reinsurance recoverable of the Company which contained $15,327,000, was not adequate to cover the liabilities ceded to USA Casualty totaling $31,967,000. This resulted in an examination increase to the Provision for Reinsurance of $16,640,000 and a decrease in surplus of the same amount.

Since the date of the examination, the reinsurance recoverable from USA Casualty has been reduced due to an increase in funds placed in the escrow account and a decrease in the reinsurance recoverable as the ceded business has run off. As of December 31, 2006, the reinsurance recoverable was $24,115,000 and the escrow account held a balance of $19,238,722, a gap of $4,876,278. By March 31, 2007, the reinsurance recoverable was further reduced to $22,818,124 and the escrow account held a balance of $19,367,477, resulting in a gap of $3,450,648. These changes resulted in a decrease in the Provision for Reinsurance and an increase to Surplus of $11,763,913 and $13,189,543 respectively.

Based on the declining liability, USA Casualty has requested that the California Department of Insurance release an additional $5,000,000 that has been held in a deposit for the benefit of California workers' compensation policyholders reinsured by USA Casualty. USA Casualty has agreed to place a portion of this released deposit in the escrow account in order to ensure that the balance in the escrow account is equal to the reinsurance recoverable due to the Company from USA Casualty. If this occurs reinsurance ceded will be fully funded

Reinsurance Intermediary Settlement

In June 2006, the Company entered into a settlement agreement with a former reinsurance intermediary, and the Company accrued $4 million of miscellaneous income as of June 30, 2006. The Company received the $4 million settlement in August 2006.

Consolidation of Operations

During 2006, the Company consolidated operations and eliminated offices in Kansas City and severely reduced its workforce located in San Francisco and Chino, California. Most of the claims and underwriting workload performed at those locations was diverted to the main office.

A. M. Best Rating Upgrade

On December 7, 2006, A.M. Best announced a rating upgrade for Ulico Casualty Company from B (fair) to B+ (very good) with a stable outlook. The upgrades were based upon improvements in key areas that have led to strengthened capitalization, operating performance and internal control standards.

Name Change

On November 17, 2006, Articles of Amendment to the Articles of Incorporation were filed with the Delaware Secretary of State and the Delaware Department of Insurance amending the Certificate of Authority and reflecting the name change to ULLICO Casualty Company as of March 5, 2007.